Report

of the

Examination of

MercyCare Insurance Company

Janesville, Wisconsin

As of December 31, 2001

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, *Governor*
Jorge Gomez, *Commissioner*

Wisconsin.gov

121 East Wilson Street • P.O. Box 7873
Madison, Wisconsin 53707-7873
Phone: (608) 266-3585 • Fax: (608) 266-9935
E-Mail: information@oci.state.wi.us
Web Address: oci.wi.gov

January 8, 2003

Honorable Jorge Gomez
Commissioner of Insurance
121 East Wilson Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

MERCYCARE INSURANCE COMPANY
Janesville, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of MercyCare Insurance Company (MCIC) was conducted in 1999 as of December 31, 1998. The current examination covered the intervening period ending December 31, 2001, and included a review of such 2000 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Provider Contracts
Territory and Plan of Operations
Affiliated Companies
Growth of the Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

II. HISTORY AND PLAN OF OPERATION

MercyCare Insurance Company can be described as a for-profit stock insurance company organized under ch. 611, Wis. Stat. that offers a group model health maintenance organization product. A health maintenance organization is defined by s. 609.01 (2), Wis. Stat., as ". . . a health care plan offered by an organization established under ch. 185, 611, 613, or 614 or issued a certificate of authority under ch. 618 that makes available to its enrolled participants, in consideration for predetermined fixed payments, comprehensive health care services performed by providers selected by the organization." Under the group model, the company contracts with a sponsoring clinic to provide primary and specialist services. HMOs compete with traditional fee-for-service health care delivery.

The company was incorporated September 14, 1993, and commenced business September 16, 1993. The company is sponsored by Mercy Health System Corporation, which is part of the Southern Wisconsin Health Care System, Inc., a multi-faceted health care holding company system.

All members must choose a primary care physician when enrolling in the plan. Generally, referrals are not necessary if the member sees a specialist in MCIC's provider network. Referrals, outside the network, must be pre-approved. The plan has approximately 105 contracted primary care physicians and 334 specialists.

MCIC provides most of the health care services covered by its benefit contracts to enrollees through a contract with its parent, Mercy Health System Corporation (MHS). MHS agrees to provide inpatient, outpatient, other services customarily provided by the hospital and physician services to enrollees. The contract has hold-harmless provisions that prohibit MHS from billing enrollees for covered services and MHS is subject to the statutory hold-harmless provisions of ch. 609, Wis. Stat. Should the company become insolvent, MHS agrees to provide covered services to enrollees hospitalized on the date of insolvency until the member is discharged. The contract has an initial term ending December 31, 1994, and automatically renews for additional terms of one year unless one party notifies the other of its intent not to renew at least 90 days prior to the end of the term. Hospital inpatient and hospital outpatient are

capitated with MHS. The physicians are paid at the lesser of billed charges or Ingenix "Relative Values for Physicians."

In addition to Mercy Health System, the company contracts with the following medical groups:

Health Care Management Services
Internet Medicine and Pediatrics, S.C.
Medical Associates of Fort Atkinson
University of Wisconsin Clinics
Watertown PHO

The company currently contracts with individual physicians for primary care and specialty services, as well as, contracts for ancillary and mental health services. The contracts include hold-harmless provisions for the protection of policyholders. The contracts have a one-year term and may be terminated upon 60 days' prior written notice by either party. These contracts limit the providers' risk to services rendered.

In addition to Mercy Hospital of Janesville, Wisconsin, a subsidiary of MHS, MCIC contracts with the following hospitals:

Wisconsin
Fort Atkinson Memorial Hospital - Fort Atkinson
Memorial Community Hospital - Edgerton
Meriter Hospital - Madison (only upon referral)
Milwaukee Children's Hospital - Milwaukee (only upon referral)
University of Wisconsin Hospital - Madison (only upon referral)
Watertown Hospital - Watertown

Illinois
Advocate - Barrington
Harvard Hospital - Harvard
St. Alexis - Hoffman Estates
Sherman Hospital - Elgin

As mentioned earlier, Mercy Hospital is capitated for the services they perform. The other hospitals listed are reimbursed on a discounted fee-for-service basis. These contracts also include hold-harmless provisions for the protection of policyholders.

According to its business plan, the company's service area is comprised of the following counties:

Wisconsin	**Illinois**
Rock	Boone
Green	McHenry
Jefferson	Winnebago
Walworth	Kane
Dane	Lake

The company offers comprehensive health care coverage, which may be changed by riders to include deductibles and copayments. The following basic health care coverages are provided:

Physician services
Inpatient services
Outpatient services
Mental health and substance abuse services
Ambulance services
Special dental procedures (oral surgery)
Prosthetic devices and durable medical equipment
Newborn services
Home health care
Preventive health services
Family planning
Hearing exams and hearing aids
Diabetes treatment
Routine eye examinations
Convalescent nursing home service
Prescription drugs--various copayments
Cardiac rehabilitation, physical, speech, and occupational therapy
Physical fitness or health education ($50.00 per year maximum)
Kidney disease treatment
Certain transplants
Chiropractic services

Outpatient mental health coverage is limited to 30 visits per year. Inpatient and AODA coverage is limited to 15 visits per year and for each type of coverage. Emergency services have a range of $0 to $100 copayment, which may be waived upon admission into an inpatient facility. Skilled nursing care coverage ranges from 30 to an unlimited number of days per confinement, hearing aids are limited to one per year every 36 months, infertility lifetime maximums range from $2,000 to unlimited, and PT/OT/ST are limited to 30 visits per contract year per therapy. Plan coverage is contingent on non-emergency services being provided by participating physicians and hospitals or on the referral of participating physicians. The company has plans in which office visits have co-payments ranging from $0 to $50. Some plans also have

a 0% to 20% coinsurance requirement, subject to out-of-pocket maximums ranging from $500 to $7,000/single and $1,200 to $14,000/family.

The company currently markets to groups and Medicare individuals and has a Medicaid contract. The company uses an internal marketing staff as well as outside agencies and pays a fixed dollar amount commission based on group size on new and renewal business. There are approximately 110 independent agents writing for the plan.

The company uses an actuarially determined base as a beginning point in premium determination. This rate is adjusted to reflect the age, sex, occupation, and coverage characteristics, and individual medical history (small groups: 2-50 employees) for new groups. Experience (if available) is reviewed, as well, for new and renewal groups. Based on the experience, a recommendation is made regarding adjustments to the rates. The base rate is adjusted as needed for inflation and other trending factors.

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of seven members. All directors are elected annually to serve a one-year term. Officers are appointed by the board of directors. Members of the company's board of directors may also be members of other boards of directors within the holding group. The board members currently receive no compensation for serving on the board.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Javon R. Bea Janesville, Wisconsin	President and CEO Mercy Health System	2002
Alfred H. Diotte Janesville, Wisconsin	Secretary and Treasurer Retired Executive	2002
Mark L. Goelzer, M.D. Janesville, Wisconsin	Director of Medical Affairs and Pediatrician	2002
William Ryan Janesville, Wisconsin	Chairperson and CEO Ryan Incorporated Eastern	2002
Eugene H. Seibert Fountain Hills, Arizona	Vice Chairperson President, Seibert Associates	2002
Stephen R. Van Galder Janesville, Wisconsin	Chairperson Van Galder Bus Company	2002
Sima D. Wexler Janesville, Wisconsin	Retired Owner J.J. Smith's Jewelry Stores	2002

Officers of the Company

The officers appointed by the board of directors and serving at the time of this examination are as follows:

Name	Office	Current Salary
Javon R. Bea	President	$0*
Alfred P. Diotte	Secretary	0*
Joseph D. Nemeth	Treasurer	0*
Phillip Bedrossian	Medical Director	0*

* These officers receive compensation from their positions with Mercy Health System and receive no compensation for their services as MercyCare Insurance Company officers.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. All other business is conducted at the board meetings.

The company has no employees. Necessary staff is provided through a management agreement with Mercy Health System Corporation (MHS). Under the agreement, effective July 1st, 2002, MHS agrees to negotiate employer, provider, subscriber, and other contracts; advises the board; maintains accounting and financial records; recruits marketing, utilization review, and claims processing personnel; provides or contracts for claims processing, and MIS. MHS receives the actual cost to perform the function plus 3% to cover any non-specific cost associated with the service as compensation for services rendered. The term of the agreement is three years. The company may terminate the agreement upon 30 days' written notice if default of standards of performance continues 60 days after notice of such default.

Financial Requirements

The financial requirements for the company under s. Ins 51.80, Wis. Adm. Code, are as follows:

		Amount Required
Compulsory surplus:		$2,000,000, if organized on or after January 1, 1982 or an amount required by statue or administrative order before that date.
	or	
		The sum of the following: a) 15% of premium for individual life and disability insurance; b) 10% of premium for group life and disability insurance; c) The greater of 2% of reserves or 7 1/2% of premiums for annuities and deposit administration funds; d) 20% of premiums for all other covered lines of insurance

Insolvency Protection for Policyholders

Under s. Ins 9.04 (6), Wis. Adm. Code, HMOs are required to provide continuation of coverage for its enrollees. These requirements are the following:

1. Enrollees hospitalized on the date of insolvency will be covered until discharged; and

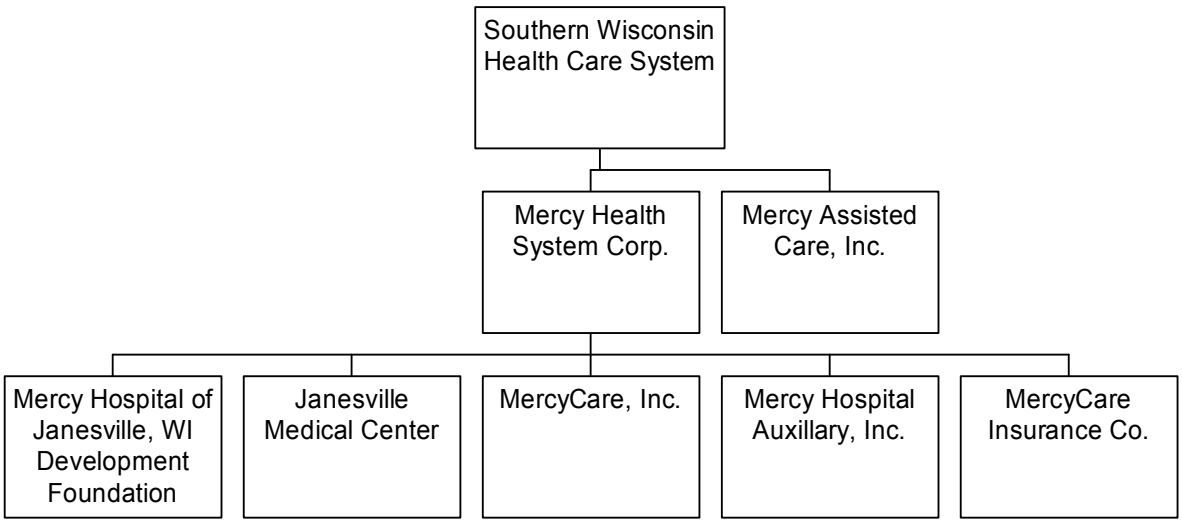
2. Enrollees will be entitled to similar, alternate coverage which does not contain any medical underwriting or preexisting limitation requirements.

The company has met this requirement through its reinsurance contract, as discussed in the Reinsurance section of this report.

IV. AFFILIATED COMPANIES

The company is a member of a holding company system. Its ultimate parent is Southern Wisconsin Health Care System, Inc. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the significant affiliates of the company follows the organizational chart.

Holding Company Chart
As of December 31, 2001



Southern Wisconsin Health Care System (SWHCS)

SWHCS is a nonprofit multi-faceted healthcare holding company. As of June 30, 2001, the company's audited financial statement reported assets of $140,631,360, liabilities of $13,219, and unrestricted net assets of $140,618,141. Operations for 2001 produced net income of $12,210,833 on revenue of $235,578,402..

Mercy Health System Corporation (MHS)

MHS provides a comprehensive range of services including Mercy Hospital - a 240 bed acute care hospital; Mercy Manor - an 81 bed skilled nursing facility; 66 community based residential facility beds; 24 community care centers which provide physician services, and 14 other health services sites located throughout MHS's service area.

As of June 30, 2001, the company's audited financial statement reported assets of $224,385,701, liabilities of $22,385,515, and unrestricted net assets of $224,385,701. Operations for the fiscal year produced net income of $12,257,788 on revenue of $203,206,481.

V. REINSURANCE AND CORPORATE INSURANCE

The company has reinsurance coverage under the contract outlined below:

Reinsurer:	Reliastar Life Insurance Company
Type:	Specific Excess of Loss Reinsurance
Effective date:	January 1, 2001
Retention:	$100,000 of eligible services per Commercial HMO and Point of Service member in each contract year. $50,000 of eligible services per Medicaid and BadgerCare member in each contract year.
Coverage:	80% of eligible hospital services and eligible physicians services losses in excess of the annual deductible.
Premium:	$4.19 per member per month for Commercial HMO and Point of Service members $1.75 per member per month for Medicaid and BadgerCare members
Termination:	The contract has a one-year term and may be terminated by the reinsurer at the end of a contract year upon thirty days prior written notice.

The reinsurance policy has an endorsement containing the following insolvency provisions:

1. Reinsurer will continue plan benefits for members who are confined in an acute-care hospital on the date of insolvency until their discharge.

2. Reinsurer will continue plan benefits for any member insured plan until the end of the contract period for which premiums have been paid to plan by that member or on his behalf.

3. Reinsurer will make available to all members for a period of thirty days, without evidence of insurability, a replacement coverage of the same benefit schedule and rates as then being offered by reinsurer to other prospective insureds within the state.

In addition, the company is provided with corporate insurance coverage under the contracts listed below:

Type of Coverage	Policy Limits
Errors & Ommissions liability	$3,000,000 aggregate
Professional liability	3,000,000 aggregate
Comprehensive general liability	1,000,000 aggregate

The above coverages were obtained through OHIC Insurance Company, which is licensed in Wisconsin.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 2001, annual statement to the Commissioner of Insurance. Also included in this section are schedules that reflect the growth of the company for the period under examination.

MercyCare Insurance Company
Assets
As of December 31, 2001

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$ 6,364,128	$	$ 6,364,128
Cash and short-term investments	6,164,024		6,164,024
Accident and health premiums due and unpaid	90,624		90,624
Amounts recoverable from reinsurers	314,656		314,656
Investment income due and accrued	120,509		120,509
Amounts due from parent, subsidiaries and affiliates	1,312		1,312
Federal and foreign income tax recoverable and interest thereon	920,686	753,510	167,176
Aggregate write-ins for other than invested assets	135,000		135,000
Total assets	$14,110,939	$753,510	$13,357,429

MercyCare Insurance Company
Liabilities and Net Worth
As of December 31, 2001

Claims unpaid		$ 5,485,685
Premiums received in advance		1,615,799
Amounts due to parent, subsidiaries and affiliates		870
Aggregate write-ins for other liabilities (including $(1) current)		164,248
Total liabilities		7,266,602
Common capital stock	$1,000,000	
Gross paid in and contributed surplus	3,881,419	
Surplus notes	3,900,000	
Aggregate write-ins for other than special surplus funds	167,176	
Unassigned funds (surplus)	(2,857,768)	
Total capital and surplus		6,090,827
Total liabilities, capital and surplus		$13,357,429

MercyCare Insurance Company
Statement of Revenue and Expenses
For the Year 2001

Net premium income		$57,611,413
Aggregate write-ins for other health care related revenues		12,398
Total revenues		57,623,811
Medical and Hospital:		
Hospital/medical benefits	$52,135,401	
Less		
Net reinsurance recoveries	603,153	
Total medical and hospital	51,532,248	
General administrative expenses	5,639,418	
Total underwriting deductions		57,171,666
Net underwriting gain or (loss)		452,145
Net investment gains or (losses)		531,740
Net income or (loss) before federal income taxes		983,885
Federal and foreign income taxes incurred		41,000
Net income (loss)		$ 942,885

MercyCare Insurance Company
Capital and Surplus Account
As of December 31, 2001

Capital and surplus prior reporting year		$4,193,959
Net income or (loss)	$942,885	
Change in net deferred income tax	167,176	
Change in surplus notes	400,000	
Cumulative effect of changes in accounting principles	386,807	
Net change in capital and surplus		1,896,868
Capital and surplus end of reporting year		$6,090,827

MercyCare Insurance Company
Statement of Cash Flows (Indirect Method)
As of December 31, 2001

Cash from Operations			
Premiums and revenues collected net of reinsurance			$58,962,876
Claims and claims adjustment expenses			49,512,255
General administrative expenses paid			5,639,418
Other underwriting income (expenses)			12,398
Cash from underwriting			3,823,601
Net investment income			530,607
Other income (expenses)			31,986
Federal and foreign income taxes (paid) recovered			(41,000)
Net cash from operations			4,345,194
Cash from Investments			
Proceeds from investments sold, matured or repaid:			
Bonds	$ 999,985		
Stocks	3,869,119		
Total investment proceeds		$4,869,104	
Cost of investments acquired (long-term only):			
Bonds	2,887,898		
Total investments acquired		$2,887,898	
Net cash from investments			1,981,206
Cash from Financing and Miscellaneous Sources			
Cash provided:			
Surplus notes, capital and surplus paid in	400,000		
Other cash provided	101,620		
Total		501,620	
Net cash from financing and miscellaneous sources			501,620
Net change in cash and short-term investments			6,828,020
Cash and short-term investments:			
Beginning of year			(663,997)
End of year			$6,164,023

Growth of MercyCare Insurance Company

Year	Assets	Liabilities	Capital and Surplus	Premium Earned	Medical Expenses Incurred	Net Income
2001	$13,357,429	$7,266,602	$6,090,827	$57,623,811	$51,532,248	$ 942,885
2000	8,695,156	4,501,194	4,193,959	49,016,951	43,427,751	43,268
1999	9,071,188	5,330,323	3,740,865	42,197,743	40,717,953	(2,587,146)
1998	7,886,102	4,502,656	3,383,446	28,287,825	25,526,384	103,971

Year	Profit Margin	Medical Expense Ratio	Administrative Expense Ratio	Change in Enrollment
2001	1.64%	89.4%	9.8%	9.1%
2000	.09	88.6	10.6	6.8
1999	(6.13)	96.5	9.1	6.8
1998	.37	90.2	9.1	7.3

Enrollment and Utilization

Year	Enrollment	Hospital Days/1,000	Average Length of Stay
2001	29,072	220	3.7
2000	26,651	190	3.2
1999	24,946	231	3.5
1998	19,550	239	3.3

Per Member Per Month Information

	2001	2000	Percentage Change
Premiums:			
Commercial	$182.25	$159.99	13.9%
Medicare Supplement	78.71	77.31	1.8
Medicaid	122.85	113.04	8.7
Expenses:			
Hospital/medical benefits	153.96	139.45	10.4
Less: Net reinsurance recoveries	1.78	1.61	10.6
Total medical and hospital	152.18	137.84	10.4
General administrative expenses	16.65	18.99	(12.3)
Total underwriting deductions	$168.83	$156.83	7.7

Reconciliation of Capital and Surplus per Examination

The examination did not result in any adjustments however one reclassification was made:

	Debit	Credit
Aggregate Write-Ins for other than Invested Assets: Other Receivables		$135,000
Health Care Receivables	$135,000	
Total reclassifications	$135,000	$135,000

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were eight specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Investments—It is recommended that the HMO obtain a custodial agreement which would provide for the indemnification of securities and prompt replacement of the value of any loss of securities due to the negligence of the custodian.

   Action—Compliance

2. Investments—It is recommended that the HMO submit security acquisition reports (SAR) to the Securities Valuation Office in order to establish an NAIC rating for its securities.

   Action—Compliance

3. Financial Reporting—It is recommended that the HMO complete the annual statement in accordance with the NAIC Life, Accident and Health Annual Statement Instructions.

   Action—Compliance

4. Financial Reporting—It is recommended that the HMO establish a proper procedure in recording the asset valuation reserve in the annual statement.

   Action—Company has eliminated the Asset Valuation Reserve

5. Financial Reporting—It is recommended that the HMO combine the POS totals with the HMO totals when recording amounts in the annual statement.

   Action—Compliance

6. Accounts and Records—It is recommended that the HMO obtain the appropriate signatures and dates on its provider agreements.

   Action—Compliance

7. Financial Reporting—It is recommended that the company file a business plan with the Office of the Commissioner of Insurance indicating the corrective actions necessary to improve it operations and resulting impact on surplus.

   Action—Compliance

8. EDP Environment—It is recommended that the HMO take actions to ensure that improvements are made relating to the backup of data and a detailed disaster recovery plan should be established in order to preserve information.

   Action—Non-compliance, See Summary of Current Examination Results

Summary of Current Examination Results

Bylaws

The examiner reviewed the company's bylaws, which state the company shall have five members on the board of directors including the president who shall be an ex officio director with vote. Currently the company has seven members including the president. It is recommended that the company amend Article III, Section 3.01 of their bylaws to correctly identify the number of directors the company has.

Annual Statement

The examiner's review of the 2001 annual statement revealed the company did not properly identify the board of directors on the jurat page of the annual statement. One individual was listed as a board of director who is actually not on the board and another individual was not included. It is recommended that the company properly fill out the jurat page according to the NAIC Annual Statement Instructions.

Crime Coverage

In review of the insurance coverage's it was noted that the company does not have crime coverage. According to the criteria set by the NAIC Financial Examiners Handbook this coverage should be between $450,000 - $500,000. It is recommended that the company obtain crime coverage and in addition maintain the coverage at a level that would comply with the criteria set by the NAIC Financial Examiners Handbook.

Unclaimed Property

The review of the bank reconciliation revealed that the company has not been setting up a liability for long outstanding checks or submitting an unclaimed property report for checks older than five years to the State Treasurer's Office. It is recommended that the company comply with ch. 177, Wis. Stat., as regards unclaimed funds, and that a liability for unclaimed funds be established in future statutory annual statements to account for all checks outstanding for over one year.

Bonds

The company owns a bond that has a NAIC Designation of 6 by the NAIC Securities Valuation Office. According to SSAP No. 26, Paragraph 8, if it is determined that a decline in the fair value of a bond is other than temporary, the bond shall be written down to fair value and the company shall report a realized loss. The company is currently recording the bond at its book value of $101,731, however the bond should be recorded at its fair value of $93,500 and the company should have a realized loss of $10,672. No adjustment is deemed necessary due to immateriality. It is recommended that the company properly record impaired investments according to SSAP No. 26, Paragraph 8.

Investments

The examiner's review of the board of director minutes discovered the board does not approve the company's investments. The Investment Management Agency Agreement between the company and Johnson Bank Trust (Johnson) gives Johnson the authority to make investment decisions according to the criteria set by the board, however the board does not formally approve these investments. According to 611.67(3), Wis. Stats., a company may delegate management authority to a person other than an officer, director or employee of the insurer if the person exercises the management authority according to the terms of the written contract between the insurer and the person, if the contract is filed and not disapproved by this office. The custodian agreement is not a management agreement nor does it delegate investment review and approval authority. It is recommended that the company establish procedures to have investment transactions formally approved by the board of directors.

Cash

Proper internal control procedures recommend that a company obtain two signatures on checks over a set dollar amount. During review of the company's cash procedures, it was revealed that only one signature is needed on check disbursements regardless of the amount. It is recommended that the company establish procedures to require a second signature on all disbursements in excess of an amount agreed upon by the board of directors.

Financial Reporting

The examination revealed the company recorded $135,000 in Pharmacy Rebate Accrual as an Other Receivable under Aggregate Write-Ins. This should have been recorded as a Health Care Receivable on the annual statement. The examination as reclassified $135,000 from Aggregate Write-Ins to Health Care Receivable. It is recommended that the complete the annual statement in accordance with the NAIC Annual Statement Instructions.

Provider Contracts

The company makes monthly capitation payments to MHS. During review of these payments it was revealed the company does amend their provider contract with MHS when new rates go into effect. Per company personnel, there is a verbal agreement on the rates that are paid, but there is no written agreement. It is recommended that the company amend Attachment D of the MHS contract to update the capitation rates when there are changes to these rates.

Claims

Included in the company's claims payable liability is a provision for claims incurred but not reported (IBNR). In reviewing the company's calculation for IBNR accrual, the company could not produce clear documentation of the IBNR calculation. The company creates claims triangles and completion factors, however there is no link from the lag data to the final amount posted in the general ledger. It is recommended that the company document its procedures for calculating its IBNR accrual and retain these records for future reference.

Disaster Recovery Plan

The prior examination recommended that the company take actions to complete a detailed disaster recovery plan. The company rebutted the recommendation after the report was adopted stating, "We maintain that we would be able to recover our transaction system in the event of a disaster. In addition to being able to recover our transaction system in the event of a disaster."

A disaster recovery plan was requested during the current examination, which the company was unable to provide. Disaster recovery plans were discussed during the current examination. The company identified certain procedures they would do to address disaster

recovery, however the company was unable to document that these procedures formally existed. The purpose of a disaster recovery plan is to provide a detailed outline of steps a company would take in the event of a disaster. Disaster plans should be formally documented to allow their execution in the event that personnel primarily responsible for functions are not available.

In addition to the company's response regarding system availability, disaster plans would also address issues surrounding relocation of personnel, manual procedures for use until the until the electronic data processing function can be restored, formally identifying where replacement hardware and supplies would be obtained, notification of business partners, and recovery/recreation of hardcopy documentation

It is recommended that the company develop a formal detailed disaster recovery plan. In addition, the plan should be reviewed, updated, and tested annually.

System Backups

The prior examination identified that the company did not archive its backups for a period longer than seven days. A recommendation was made that at a minimum, files should be backed up and retained from the most recent financial statement period. The company rebutted the recommendation after the report was adopted, stating its method of using seven days of rotational tape was adequate.

The current examination did not experience any issues with the company being able to provide data. There is still a concern that the company's short period of archiving its backups could result in loss of data, especially considering the diminutive expense of creating and retaining additional archives.

The prior examination recommended that a procedure be established whereby at least weekly backup data is stored at the administrative site rather than at the hospital complex. The company believed that the location of the tape storage at the hospital was adequate as the tapes were stored in a building that was not connected to the hospital. The current examination identified that while the location was reasonable, the security surrounding the tapes was not. Although the tapes were stored in a secured container, this container was located in an area accessible to non-IT personnel and the container was not waterproof or fireproof.

It is recommended that the company expand its data backup archives and these archives be stored in a locked, waterproof, and fireproof container where access is limited.

Application Access

The current examination identified the company had several IDs that had access to the data in their administration application PowerhouseMHS. However, access to the data was no longer needed due to employees no longer working for the company, temporary IDs which still had access, IDs for a Third Party Administrator no longer processing for the company, and multiple IDs for software vendors. It is recommended that the company establish a procedure to verify that only authorized active IDs are allowed access to the data in the their administration application.

Compulsory Surplus Requirement

As noted in the section of this report captioned "Financial Requirements," companies are required to maintain minimum compulsory surplus. The company's calculation as of December 31, 2001, is as follows:

Assets	$13,357,429	
Less liabilities	7,266,602	
Total		$6,090,827
Net premium earned	57,611,413	
Compulsory factor	10%	
Compulsory surplus		5,761,141
Compulsory Excess		$ 329,686

IX. CONCLUSION

MercyCare Insurance Company can be described as a for-profit group model health maintenance organization insurer organized under ch. 611, Wis. Stat. The company commenced business on September 16, 1993. MercyCare is sponsored by Mercy Health System Corporation, which is part of the Southern Wisconsin Health Care System, Inc., a multi-faceted health care holding company.

Since the last examination as of December 31, 1998, the reported assets increased from $7.9M to $13.4M and liabilities increased from $4.5M to $7.3M. These amounts represent increases of 69% and 61%, respectively. The company experienced a 49% growth in membership during the examination period. Enrollment increased from 19,550 members in 1998 to 29,072 members at the end of 2001. Overall premium has increased 104% from $28.3M to $57.6M.

The company complied with seven out of eight of the prior examination recommendations. This examination resulted in thirteen recommendations and one reclassification.

X. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 22 - Bylaws—It is recommended that the company amend Article III, Section 3.01 of their bylaws to correctly identify the number of directors the company has.

2. Page 22 - Annual Statment—It is recommended that the company properly fill out the jurat page according to the NAIC Annual Statement Instructions.

3. Page 22 - Crime Coverage—It is recommended that the company obtain crime coverage and in addition maintain the coverage at a level that would comply with the criteria set by the NAIC Financial Examiners Handbook.

4. Page 22 - Unclaimed Property—It is recommended that the company comply with ch. 177, Wis. Stat., as regards unclaimed funds, and that a liability for unclaimed funds be established in future statutory annual statements to account for all checks outstanding for over one year.

5. Page 23 - Bonds—It is recommended that the company properly record impaired investments according to SSAP No. 26, Paragraph 8.

6. Page 23 - Investments—It is recommended that the company establish procedures to have investment transactions formally approved by the board of directors.

7. Page 23 - Cash—It is recommended that the company establish procedures to require a second signature on all disbursements in excess of an amount agreed upon by the board of directors.

8. Page 24 - Financial Reporting—It is recommended that the company complete the annual statement in accordance with the NAIC Annual Statement Instructions.

9. Page 24 - Provider Contracts—It is recommended that the company amend Attachment D of the MHS contract to update the capitation rates when there are changes to these rates.

10. Page 24 - Claims—It is recommended that the company documents its procedures for calculating its IBNR accrual and retain these records for future reference.

11. Page 24 - Disaster Recovery Plan—It is recommended that the company develop a formal detailed disaster recovery plan. In addition, the plan should be reviewed, updated, and tested annually.

12. Page 25 - System Backups—It is recommended that the company expand its data backup archives and these archives be stored in a locked, waterproof, and fireproof container where access is limited.

13. Page 26 - Application Access—It is recommended that the company establish a procedure to verify that only authorized active IDs are allowed access to the data in their administration application.

XI. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company is acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
Rebecca Easland	Financial Examiner
Randy Milquet	Financial Examiner - Advanced

Respectfully submitted,

Sonja M. Dedrick
Examiner-in-Charge